COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, JANUARY 5, 2005

APPLICATION OF

VERIZON VIRGINIA INC.
and
VERIZON SOUTH INC.

CASE NO. PUC-2004-00092

For Approval of a Plan for
Alternative Regulation

FINAL ORDER

On July 9, 2004, Verizon Virginia Inc. ("Verizon Virginia") and Verizon South Inc. ("Verizon South") (collectively, "Verizon" or the "Companies") filed an application with the State Corporation Commission ("Commission") for approval of a newly proposed alternative regulatory plan ("Plan") pursuant to § 56-235.5 of the Code of Virginia ("Code").

On July 20, 2004, the Commission issued an Order for Notice and Comment that, among other things: (1) docketed the application; (2) provided interested persons an opportunity to comment and/or request a hearing on the application; (3) required Verizon to give notice to the public of its application and of the opportunity to file comments and/or requests for hearing; and (4) directed the Commission's Staff ("Staff") to conduct an investigation into the reasonableness of the application and to present its findings in a Staff Report. On September 30, 2004, after receiving public comments and requests for hearing, the Commission issued an Order for Notice and Hearing that, among other things, scheduled a public hearing in the matter to commence on November 22, 2004.

In its application, Verizon states that the Plan contains the following major provisions:

- Prices for each Verizon company's basic local exchange telephone services ("BLETS") can be increased up to a price ceiling consisting of the highest prices charged by either Verizon company for the same services.

- Price increases up to the ceiling are limited to 10% during the first twelve months following the effective date of the Plan, and are thereafter limited to an equivalent of 10% per twelve month period.

- The price ceiling will be increased annually by the rate of inflation, as measured by the Gross Domestic Product Price Index ("GDPPI"), beginning on the first anniversary of the effective date of the Plan.

- Price increases for other local exchange telephone services ("OLETS") are limited to an equivalent of 10% per twelve-month period (as in the current plan).

- Tariffed Bundled Services can be offered upon notification to the Commission.

- Revenue-neutral price changes, which can include BLETS, OLETS, and switched access services, can be made by Verizon upon a Commission finding that they are in the public interest.

- Price decreases for retail services are allowed, subject to a price floor.

Verizon asserts that the only significant changes from the current plan would allow incremental increases in BLETS prices up to a reasonable ceiling, enable Verizon to propose revenue-neutral price changes that can include switched access services, and establish a link between the rules applying to competitive local exchange carriers ("CLECs") and those applying to Verizon while preserving the Commission's discretion to apply different rules, if necessary. Verizon states that given the breadth of competition in the Commonwealth today, these new features represent modest but essential steps in the right direction of providing Verizon the increased pricing flexibility it needs to respond to industry developments. In addition, Verizon argues that the Plan meets the four statutory requirements contained in § 56-235.5 B of the Code:

> (i) protects the affordability of basic local exchange telephone service, as such service is defined by the Commission; (ii) reasonably ensures the continuation of quality local exchange telephone service; (iii) will not unreasonably prejudice or disadvantage any class of telephone company customers or other providers of competitive services; and (iv) is in the public interest.

The Commission received over 50 written and/or electronic public comments on Verizon's application.[1] Those timely filing comments opposing all or parts of the Plan included individual consumers; the Virginia Citizens Consumer Council; the Honorable Henry L. Marsh, III, Member, Senate of Virginia; Raymond H. Boone, Editor/Publisher, Richmond Free Press; Bishop Gerald O. Glenn, New Deliverance Evangelistic Church; Melvin D. Law, Richmond Crusade for Voters; Isle of Wight-Smithfield-Windsor Chamber of Commerce; Isle of Wight County Board of Supervisors; and Fairfax County Board of Supervisors.

The following parties, participating as respondents in this proceeding, filed comments on September 20, 2004: the Division of Consumer Counsel of the Office of the Attorney General ("Consumer Counsel"); the Competitive Carrier Coalition ("Coalition");[2] Cox Virginia Telcom, Inc. ("Cox"); AT&T Communications of Virginia, LLC ("AT&T"), and MCImetro Access Transmission Services of Virginia, Inc. ("MCI"); United Telephone – Southeast, Inc., Central Telephone Company of Virginia, and Sprint Communications of Virginia, Inc. (collectively, "Sprint"); and Comcast Phone of Virginia, Inc., and Comcast Phone of Northern Virginia, Inc. ("Comcast").

Consumer Counsel recommends that: (1) increases to the price ceiling should be limited to one-half the increase in the GDPPI rather than 100% of the GDPPI as proposed by Verizon; (2) increases to BLETS under the ceiling should be limited to only 5% per year rather than 10% as proposed; (3) any additional revenues generated through rate increases allowed by modifications to Verizon's current plan should be used to offset any revenue reductions from

[1] The Commission's July 20, 2004, Order for Notice and Comment, as amended by the August 12, 2004, Order Extending Procedural Schedule, required written and/or electronic comments to be submitted on or before September 20, 2004.

[2] The members of the Coalition are: ACN Communications Services, Inc.; Cavalier Telephone, LLC ("Cavalier"); DIECA Communications, Inc. d/b/a Covad Communications Company; NTELOS Network, Inc., and R&B Network, Inc. (collectively, "NTELOS"); PAETEC Communications, Inc.; Starpower Communications, LLC; and XO Communications, Inc.

reduced switched access charges; and (4) Verizon Virginia should be required to modify its Virginia Universal Service Plan ("VUSP") to offer a full flat-rate service with the ability to include optional services.

The Coalition asserts that the competitive market is not even remotely as competitive as Verizon claims and that, although competitors are indeed present in the market, they clearly have been unable to restrain Verizon's market power, including its ability to raise prices, to discriminate among customers, and to reap monopoly benefits. The Coalition also contends that the Plan does not reasonably ensure the continuation of quality local exchange service, unreasonably prejudices or operates to the disadvantage of Verizon's competitors, and is not in the public interest. The Coalition argues that the competitive safeguards proposed by Verizon are insufficient to comply with § 56-235.5 H of the Code. In addition, the Coalition asserts that approval of the Plan is inconsistent with the local competition policy embodied in § 56-235.5:1 of the Code. The Coalition concludes that Verizon's proposed Plan should be denied.

Cox asserts that the Plan unreasonably disadvantages other providers of competitive services in violation of §§ 56-235.5 B (iii) and 56-235.5 H of the Code. Cox asserts that the following modifications to the Plan are required in order to satisfy such statutory requirements: (1) BLETS and OLETS should be classified as Retail Services; (2) self-provisioning of Service Components by competitors or third-parties should not impact the competitive safeguards for Verizon Retail Services; (3) consistent competitive safeguards should apply to all Retail Services; (4) the cross-subsidy test should be applied to individual services; (5) non-basic retail service should be classified and regulated consistently; (6) an application and cost support showing should be required for the reclassification of services to the Competitive Services category; (7) competition from counties, cities, and towns should not trigger automatic classification as Competitive Services; (8) the Plan should allow any party to request an

investigation of any rate change to ensure that predatory pricing or a price squeeze does not occur, and a price floor study in compliance with the competitive safeguards should be submitted to the Commission upon request; (9) the Commission should ensure that Verizon continues to comply with any applicable wholesale service quality requirements so that competitors continue to be treated in the same fashion as Verizon's retail customers; and (10) Verizon should be required to provide the Commission documentation that the competitive safeguards and cross-subsidy requirements under the Plan are met.

AT&T and MCI do not object to Commission approval of the Plan, provided that on the same day the new Plan becomes effective Verizon also must reduce its intrastate switched access rates to the cost-based levels recommended by the Hearing Examiner in Case No. PUC-2003-00091. AT&T and MCI state that it is a proven fact that Verizon's high access rates are causing AT&T, MCI, and other interexchange carriers to lose substantial business to wireless carriers and computer technologies that are not required to pay switched access fees. AT&T and MCI assert that Virginia law mandates that anticompetitive and discriminatory pricing practices be eliminated whenever the Commission approves an alternative plan of regulation.

Sprint states that it does not view Verizon's proposed Plan as binding on Sprint and that it may propose a plan in its own application that differs from Verizon's in some respects. In addition, Sprint opposes Verizon's proposed price floor safeguard because its flawed standards combined with its vague exception language do not adequately safeguard competitive markets as required by § 56-235.5 H of the Code. Instead, Sprint supports the use of a total service long-run incremental cost standard as being the most appropriate and commonly used price floor standard in the industry.

Comcast states that the Commission should ensure that Verizon's attainment of pricing flexibility does not jeopardize its obligation to competitive service providers regarding

interconnection and does not result in the Commission relinquishing its jurisdiction to ensure that Verizon dispatches these obligations efficiently and in a non-discriminatory manner.

On October 15, 2004, the Staff filed its Report on the Plan. The Staff states that it does not believe Verizon has sufficiently demonstrated that the Plan: protects the affordability of basic local exchange telephone service; reasonably ensures the continuation of quality local exchange telephone service; does not unreasonably prejudice or disadvantage telephone customers or competitors; and is in the public interest. The Staff asserts that the Plan could be modified to meet the necessary statutory requirements if it is amended to address the following eighteen concerns identified in the Staff Report: (1) price increases linked to service quality; (2) tariff requirements for competitive services; (3) revenue-neutral filings; (4) reference to local rules; (5) ceiling rates for BLETS; (6) rate groups; (7) extended local service ("ELS") adder rates; (8) classification of services; (9) VUSP; (10) price increases for BLETS; (11) individual-case-basis pricing; (12) reporting requirements; (13) monitoring of competitive services; (14) cost support for bundled services; (15) price floor; (16) access charges and two-year true-up; (17) classification filings; and (18) "deemed" competitive services.

On October 29, 2004, Verizon filed a response and proposed minimal revisions to the Plan. Verizon asserts it has shown that the proposed BLETS pricing rules will ensure affordability, that the Plan will ensure the continuation of quality local exchange service, and that the Plan meets the public interest standard. Verizon also contends that no party has undermined Verizon's showing that the Plan protects against unreasonable prejudice to or disadvantage of any class of customers or competitors. Verizon argues that the other parties' proposed modifications to the Plan are not necessary to meet the statutory standards and should be rejected. In addition, Verizon states that it does not rely on evidence of competition to show the Plan satisfies § 56-235.5 B but that understanding the full extent of competition in the market –

while a secondary issue in this case – is nonetheless important when considering the urgent need to adopt a new plan. In this regard, Verizon concludes that the other parties have failed to conduct economically sound analyses of competition. Verizon asserts that the Commission can only ignore competition and the policy implications of competition at the peril of sound public policy. Verizon contends that its Plan achieves precisely the legislative objectives in the General Assembly's local competition policy as codified at § 56-235.5:1, puts Verizon on a more equal footing with its competitors, and allows Verizon to increase rates kept artificially low in some areas. Verizon concludes that if the Commission were to reject the Plan, it would frustrate competitive development in utter disregard for the policies adopted by the General Assembly.

The public evidentiary hearing was held on November 22, 23, and 29, 2004. Lydia R. Pulley, Esquire, Jennifer L. McClellan, Esquire, and Robert P. Slevin, Esquire, appeared on behalf of Verizon. Judith Williams Jagdmann, Esquire, and C. Meade Browder, Jr., Esquire, appeared on behalf of Consumer Counsel. Russell M. Blau, Esquire, appeared on behalf of the Coalition. Stephen T. Perkins, Esquire, appeared on behalf of Cavalier. Cliona M. Robb, Esquire, and E. Ford Stephens, Esquire, appeared on behalf of Cox. Mark A. Keffer, Esquire, appeared on behalf of AT&T. Eric M. Page, Esquire, and Dulaney L. O'Roark, III, Esquire, appeared on behalf of MCI. Edward Phillips, Esquire, and Anthony Gambardella, Esquire, appeared on behalf of Sprint. Robert M. Gillespie, Esquire, and John K. Shumate, Jr., Esquire, appeared on behalf of the Staff.

The following public witnesses testified in opposition to the Plan: Delores A. Elam; the Honorable Henry L. Marsh, III, Member, Senate of Virginia; Greg Wolfrey, County Administrator, Goochland County; the Honorable R.M. Reggie Malone, Sr., Member, School Board of the City of Richmond; Susan Rubin, Assistant Director of Governmental Relations, Virginia Farm Bureau Federation; Raymond H. Boone, Editor/Publisher, Richmond Free Press;

James Edward Sheffield, Esquire; Melvin D. Law, Richmond Crusade for Voters; King Saleem Khalfani, Executive Director, Virginia State Conference, NAACP; Ellen F. Robertson; August Moon; and Irene E. Leech, President, Virginia Citizens Consumer Counsel. No public witnesses testified in support of the Plan.

In addition, William E. Taylor, Senior Vice President of NERA Economic Consulting, and Robert W. Woltz, Jr., President of Verizon Virginia, testified on behalf of Verizon. Marvin H. Kahn, Consulting Economist, testified on behalf of Consumer Counsel. Robert M. Keane, President and COO of Cavalier, testified on behalf of Cavalier and the Coalition. Wayne Lafferty, Principal in the Barrington-Wellesley Group, Inc., testified on behalf of Cox. Penny L. Sedgley, Principal Research Analyst in the Commission's Division of Economics and Finance, Steven Bradley, Deputy Director in the Commission's Division of Communications, and Kathleen A. Cummings, Deputy Director in the Commission's Division of Communications, testified on behalf of the Staff.[3]

The following participants filed post-hearing briefs on December 13, 2004: Verizon; Consumer Counsel; Cox; the Coalition; AT&T and MCI, jointly; and the Staff.

NOW THE COMMISSION, having considered the record, the pleadings, and the applicable law, is of the opinion and finds as follows. We approve the Plan subject to the modifications required by this Final Order. The approved Plan is attached hereto as Attachment A.

As noted above, there has been a significant amount of opposition to the Plan expressed in the public comments and public testimony in this proceeding. In addition, the Staff and the parties to this case have objected to and/or proposed numerous modifications to the Plan. In this

[3] In addition, the parties stipulated to the Staff testimony of Amy J. Gilmour, Telecommunications Competition Specialist in the Commission's Division of Communications.

regard, the criteria that the Commission must apply in evaluating the Plan have been explicitly set forth by the General Assembly. Section 56-235.5 C of the Code states that the "Commission shall approve the application if it finds, after notice to all affected parties and hearing, that the proposal meets the criteria for an alternative form of regulation set forth in subsection B" (emphasis added). Subsection B of 56-235.5 lists the following legal criteria:

> (i) protects the affordability of basic local exchange telephone service, as such service is defined by the Commission; (ii) reasonably ensures the continuation of quality local exchange telephone service; (iii) will not unreasonably prejudice or disadvantage any class of telephone company customers or other providers of competitive services; and (iv) is in the public interest.

In addition, § 56-235.5 H of the Code states that "[w]henever the Commission adopts an alternative form of regulation pursuant to subsection B … the Commission shall adopt safeguards to protect consumers and competitive markets. At a minimum these safeguards must ensure that there is no cross subsidization of competitive services by monopoly services." Finally, § 56-235.5:1 of the Code ("Local Competition Policy") mandates that

> [t]he Commission, in resolving issues and cases concerning local exchange telephone service under … this title … shall, consistent with federal and state laws, consider it in the public interest to, as appropriate, (i) treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, apply the same rules to all providers of local exchange telephone services; (ii) promote competitive product offerings, investments, and innovations from all providers of local exchange telephone services in all areas of the Commonwealth; and (iii) reduce or eliminate any requirement to price retail and wholesale products and services at levels that do not permit providers of local exchange telephone services to recover their costs of those products and services.

Thus, we must evaluate the Plan, and the objections thereto, according to these statutory criteria. We find that the modifications discussed below are necessary in order for the Plan to satisfy the statutory requirements.

Price Changes for BLETS and OLETS

Section F of the Plan governs the price changes for BLETS and OLETS. The General Assembly has established an explicit criterion that we must apply herein; we must determine whether Verizon's proposal "protects the affordability of [BLETS]." Va. Code § 56-235.5 B (i). Thus, the statutory test that we must apply is not whether the Plan results in "just and reasonable" rates, results in the lowest possible cost-based rate, or results in a rate that "best" protects the affordability of BLETS. Obviously, the most affordable price for BLETS would be one that never increases, but that is neither realistic nor intended by the statute.

When we approved Verizon's regulatory plan in 1994, we found that the 1994 BLETS rates were affordable:

> In the Commission's opinion, the evidence establishes that at current rate levels, those services that are classified as BLETS ... are affordable.[4]

Indeed, in that prior proceeding, both Verizon and the Staff agreed that the 1994 rates were affordable for each rate group at that time.[5] Nonetheless, when we approved Verizon Virginia's current regulatory plan, we also concluded that limiting future increases to 50% of the GDPPI protected the affordability of BLETS. In the instant proceeding, Verizon witness Taylor presented an analysis of the affordability of Verizon's BLETS rates by examining historic rates of inflation, median income growth, and service penetration rates. Dr. Taylor found, among other things, that between 1994 and 2004 median incomes in Virginia have increased faster than

[4] Commonwealth of Virginia, At the relation of the State Corporation Commission, Ex Parte: In the matter of investigating telephone regulatory methods pursuant to Virginia Code § 56-235.5, etc., Case No. PUC-1993-00036, 1994 S.C.C. Ann. Rep. 262, 263 (Oct. 18, 1994) ("1994 Order").

[5] See, e.g., Ex. 36 at 6-9.

the costs of BLETS, even if the cost of BLETS includes the interstate subscriber line charge, other regulatory charges such as the Universal Service Fund and E911, and increased taxes.[6]

Thus, there is evidence in this proceeding that median incomes have risen sufficiently to find that "total residence BLETS prices are more affordable now than they were when the Commission found BLETS prices to be affordable in 1994."[7] In addition, Dr. Taylor specifically examined the affordability of business BLETS by: (1) comparing how the inflation adjusted prices for business BLETS have changed over time; and (2) comparing business BLETS prices with business revenues.[8] Dr. Taylor determined that between 1994 and 2004, business BLETS prices have remained relatively constant and have declined in real terms when inflation is taken into consideration.[9] Furthermore, Dr. Taylor found that business revenues in Virginia increased between 1994 and 2004 so that business BLETS prices now represent a smaller fraction of business revenues than they did in 1994 when the Commission found business BLETS to be affordable.[10]

We find that, to protect affordability, the price ceiling for BLETS must not exceed the highest tariffed price currently in effect for BLETS services in either company. In addition, Dr. Taylor sponsored exhibits to demonstrate the affordability of the rate ceilings under the proposed Plan by comparing projected rates under the Plan to the 1994 rates adjusted annually for inflation.[11] In this regard, we also find that, to protect affordability, the price ceiling for each

---

[6] Ex. 5 at 13.

[7] Id.

[8] Id. at 16.

[9] Id. at 16-17.

[10] Id. at 17.

[11] Exhibits 38 and 42 compare projected rates under the Plan to 1994 rates (including a $0.60 Verizon Virginia touch tone charge) adjusted annually by the Consumer Price Index ("CPI") and by the GDPPI, respectively. Exhibit 43 compares projected rates under the Plan to 1994 rates (excluding the $0.60 Verizon Virginia touch tone charge) adjusted annually by the CPI and by the GDPPI.

company-specific BLETS must not exceed the 1994 rate adjusted annually for inflation as measured by the GDPPI.

Therefore, the Plan must be modified to protect the affordability of all BLETS for customers in all rate groups and areas. Specifically, in order to protect affordability, we find that the price ceiling for each company-specific BLETS, including BLETS prices established by rate group, must not exceed the 1994 rate for that BLETS adjusted annually by the GDPPI through 2004.[12] Thus, the first sentence in Section F.2 of the Plan must read as follows in order to protect the affordability of BLETS:

> The price ceiling for each Company-specific BLETS shall be the lower of: (a) the 1994 rate for each Company-specific BLETS, including Company-specific BLETS on an individual rate group basis, adjusted annually by the Gross Domestic Product Price Index (GDPPI) through 2004; or (b) the highest tariffed price in effect for BLETS in either Company on the effective date of this Plan.[13]

As a practical matter, this means that no Verizon customer – residential or business – will pay more for BLETS than what they paid in 1994 adjusted for GDPPI-based inflation, and more than three out of four residential customers will continue to pay less than a 1994 inflation-adjusted price.[14]

---

[12] The 1994 rates referenced herein for Verizon Virginia for purposes of the Plan do not include a $0.60 touch tone charge. See Ex. 43. The $0.60 touch tone charge was in effect prior to the January 1, 1995, effective date of the regulatory plan approved in the 1994 Order. However, in approving the regulatory plan in 1994, the Commission required Verizon Virginia's predecessor to eliminate the touch tone charge. 1994 Order at 264. Thus, the rates that the Commission required to protect affordability under the regulatory plan as approved in 1994 did not include a $0.60 touch tone charge.

[13] Exhibit 43 can be used to provide an example of this standard as applied to residential rates. On Ex. 43, the 1994 rate for Verizon Virginia's Rate Group 3 is $10.89, and this increases to $12.96 when adjusted for GDPPI through 2004. The 1994 rate for Verizon South's Rate Group 9 is $14.49, and this increases to $17.25 when adjusted for GDPPI through 2004. Given that current rates are the same as the 1994 rates on Ex. 43, then the highest tariffed price for BLETS services in either company is Verizon South's Rate Group 10, which is $15.45. Thus, under the standard required herein, the price ceiling for Verizon Virginia's Rate Group 3 would be $12.96, and the price ceiling for Verizon South's Rate Group 9 would be $15.45.

[14] See Ex. 43. As in the current regulatory plan, we find that using GDPPI to serve as a limitation on price increases protects the affordability of BLETS. As discussed above, we must accept Verizon's proposed index (i.e., GDPPI) unless we find that it does not protect affordability. In addition, having determined that GDPPI provides a reasonable gauge to protect affordability, we find that GDPPI also should be used in the Plan for the "lower of" price ceiling standard required herein. We find that using GDPPI for this purpose protects the affordability of BLETS.

In addition, Verizon proposes to increase the BLETS ceiling rate annually by 100% of the GDPPI. Consumer Counsel notes that limiting ceiling increases to 50% of the GDPPI would "better assure" affordability. However, that is not the statutory criterion that we are required to apply. Rather, we must determine, in the first instance, whether Verizon's proposed 100% GDPPI increase to the ceiling protects affordability. If it does, then we cannot make changes to the Plan in order to "better" protect affordability. In this regard, we find that Verizon provided sufficient evidence to establish that BLETS affordability is protected if the ceiling is limited to the inflation gauge as measured by GDPPI. Dr. Taylor testified that, historically, median incomes in Virginia have risen almost three times faster than GDPPI.[15] Thus, Dr. Taylor concluded:

> If this trend continues, BLETS prices could, in fact, decrease relative to income; and even if the trend does not continue, BLETS prices will still be affordable since income growth should at least keep pace with inflation.[16]

We find that limiting ceiling increases to 100% of the GDPPI protects the affordability of BLETS. Again, no Verizon customer – residential or business – will pay more for BLETS than what they paid in 1994 adjusted for GDPPI-based inflation, and many customers will continue to pay less than a 1994 inflation-adjusted price.

In addition, we do not adopt the County of Fairfax's request to modify the Plan by replacing GDPPI with an index that reflects price conditions in the telephone industry. The purpose of the GDPPI in the Plan is not to reflect Verizon's costs. Rather, the purpose of the GDPPI is to represent a broad-based index of inflation and, thus, affordability. Indeed, even

[15] Ex. 5 at 15-16, n.22.

[16] Id. at 16.

Consumer Counsel's witness, Dr. Kahn, supported the use of GDPPI for the purposes of protecting affordability.[17]

Verizon also requests authority to increase rates at an annual average of 10%, with no single increase exceeding 25%. Consumer Counsel and Staff advocate a smaller annual increase of 5%, arguing that a smaller annual increase would obviously better protect affordability. However, in order to change this provision of the Plan we must find that the proposed 10% increase will not protect affordability. Given the additional restriction on the price ceiling that we require above, in addition to the evidence provided by Verizon witness Taylor regarding affordability, we find that the proposed 10% annual increase will protect affordability.

Finally, we agree with the Staff that, in order to not unreasonably prejudice or disadvantage any class of customers, Verizon should not be permitted to charge more for BLETS in a lower rate group than it does in a higher rate group. However, the rate groupings of each company do not necessarily represent like customers; that is, for example, Rate Group 3 for Verizon Virginia is not necessarily equivalent to Rate Group 3 for Verizon South. Thus, we find that this prohibition should be applied on a company-specific basis, and the following sentence must be added to Section F.4 of the Plan:

> Unless otherwise permitted by the Commission, a Company may not charge higher BLETS rates in a lower rate group than in a higher rate group for that Company.

Extended Local Service Adders

The Staff proposed to eliminate ELS Adders as part of the Plan. However, we find that no changes to ELS Adders are necessary to protect affordability or to not unreasonably prejudice or disadvantage any class of customers. ELS Adders currently are, and will remain, separate from the alternative regulatory plan. ELS Adders are available to customers pursuant to statute

[17] Kahn, Tr. at 286.

(Va. Code § 56-484.2) and are not a function of an alternative regulatory plan. Indeed, pursuant to that statute, the adoption of an ELS Adder is subject to a vote by the affected customers. Accordingly, Section F.6 of the Plan explicitly states that nothing in the Plan prohibits the establishment of an ELS Adder – and that nothing in the Plan shall permit an increase to any ELS Adder.

Virginia Universal Service Plan

Consumer Counsel and the Staff proposed changes to Verizon's VUSP. There is evidence in this case that penetration in Virginia of lifeline service offerings has increased since 1994. Verizon also notes that the relatively low rate of lifeline offerings taken in Virginia, as compared to other states, may be the result of the affordability of rates in Virginia. Regardless, we already have concluded that the rate structure approved above protects affordability; thus, there is no need to modify Verizon's VUSP in order to satisfy that statutory criterion. Moreover, we find that making any VUSP changes through an industry-wide proceeding, as opposed to a company-specific case, would further the public interest goal in the Local Competition Policy, as set forth in § 56-235.5:1 of the Code, to apply the same rules, to the greatest extent possible, to all providers of local exchange telephone services that are required to provide lifeline services.

Extended Area Calling and Exchange Usage

The Staff asserts that Extended Area Calling ("EAC") and Exchange Usage ("EU") should be classified as BLETS instead of OLETS. EAC and EU are classified as BLETS in Verizon's current regulatory plan. Verizon argues that these services should not be classified as BLETS because, if Verizon increases the price of these services by more than what the customer might find reasonable, then that customer has a choice to choose other services such as unlimited calling plans, wireless, internet, or competitive providers. However, EAC and EU are essential components of BLETS, as they are directly associated with "local" calling over customers' dial

tone lines. In addition, we find that customers with EAC or EU service represent a different class of customers than those without EAC or EU. Thus, we find that EAC and EU must remain classified as BLETS in order to not unreasonably prejudice or disadvantage any class of telephone company customers. Furthermore, as essential components of BLETS, we find that EAC and EU must remain classified as BLETS in order to protect the affordability of BLETS services.

Service Quality

We find that the Plan reasonably ensures the continuation of quality local exchange service. Section M of the Plan requires Verizon to comply with any service quality rules established by the Commission. If the Companies fail to comply with the Commission's service quality rules, they will be in violation of such rules and of the Plan. The remedies for such violations can be achieved through show cause proceedings or any other means provided by regulation or statute. Thus, we find that it is not necessary to link price increases under the Plan to service quality rules in order to reasonably ensure the continuation of quality local exchange service. In addition, we find that requiring Verizon to comply with the Commission's service quality rules, without a price link to the Plan, is consistent with the provision of the Local Competition Policy, as set forth in § 56-235.5:1 of the Code, that requires the Commission, as appropriate, to "treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, apply the same rules to all providers of local exchange telephone services."

Competitive Safeguards

We find that the Plan must be modified in certain respects in order to "not unreasonably prejudice or disadvantage … other providers of competitive services" (Va. Code § 56-

235.5 B (iii)) and/or in order "to protect … competitive markets [and] ensure that there is no cross subsidization of competitive services by monopoly services" (Va. Code § 56-235.5 H).

First, contrary to Verizon's contention, we find that the plain language in § 56-235.5 H of the Code is not limited to cross subsidization of services "in the aggregate." Indeed, Verizon's current regulatory plan protects against such cross subsidization by mandating that the price of an "individual" competitive service cover its incremental costs. We believe that if the General Assembly had intended to limit § 56-235.5 H to services in the aggregate, then the statute would so state. Thus, we continue to interpret this statute as we have in the past. We agree with Cox that a cross subsidy test that includes individual services is necessary to ensure that Verizon does not subsidize below-cost competitive services by more profitable monopoly services. Specifically, the following sentence, which is contained in the existing plan, shall be added at the end of Section K.3 of the proposed Plan in order to ensure that there is no cross subsidization of competitive services by monopoly services: "Also, the price of an individual Competitive Service must cover its incremental costs."

Next, consistent with the request by Cox, the following sentence must be added to Section K of the Plan: "Any party may request a Commission investigation of any rate to ensure that it complies with the competitive safeguards in this section." We find that this language is necessary to clarify that a party may request such an investigation in order to ensure that the Plan does not unreasonably prejudice or disadvantage other providers of competitive services and in order to protect competitive markets. However, we do not find that Cox's request to require Verizon, under the Plan, to provide a price floor study upon request is necessary to satisfy these statutory requirements. The ability to request an investigation is sufficient; the necessity of any particular price floor study or other evidence will be determined in the context of any specific proceeding regarding these matters. Likewise, we do not adopt Cox's request to specify, as part

of the Plan, the procedural parameters attendant to any complaint or investigation; each such matter will proceed as warranted based on the particular circumstances of that case.

Section K.2.b of the Plan sets Verizon's price floor at: "(i) the lowest-priced combination of any Service Components that can be used to provide service, plus (ii) any direct incremental costs of other components of the Retail Service…." This standard prevents Verizon from attempting to disadvantage its competitors by setting the prices for Retail Services under the Plan too low compared to the costs for essential network elements and services. Verizon notes that the price floor "test properly requires imputation when competitors must purchase network components or services from an [incumbent local exchange carrier ('ILEC')] in order to compete with that ILEC."[18] Verizon explains that the price floor "requires that the ILEC's retail prices recover at least all of the direct costs that the ILEC incurred to provide its retail service, plus any contribution it receives from providing the relevant wholesale service components to competitors that must obtain these essential facilities from the ILEC to compete with the ILEC."[19] In other words, the proposed price floor requires Verizon's retail price to exceed the incremental cost to provide the service plus the wholesale rates Verizon would charge a competitor if the competitor wished to provide the service by purchasing elements or facilities from Verizon. As a result, Verizon cannot set prices for essential facilities and for its Retail Services at levels that would enable it to engage in a price squeeze. Furthermore, Verizon provided evidence that, because the Plan does not account for the fact that it may be less costly for Verizon to provide the essential facilities needed for its own retail services than to provide them to others, the Plan may set the price floor too high and provide ample protection against a potential price squeeze.[20] We find

[18] Verizon's Post-Hearing Brief at 66.

[19] Id. at 67.

[20] Id. at 67-68; Ex. 5 at 27-29.

that the components, noted above, of the proposed price floor satisfy the statutory criteria to not unreasonably prejudice or disadvantage other providers of competitive services and to protect competitive markets.

In addition, the Plan proposes a different price floor if competitors can self-provision. Specifically, Section K.2.b states that "where other carriers can either self-provision Service Components or obtain them from other commercial suppliers, the price floor calculation need only reflect the Company's direct incremental cost for such Service Components." We find that if Verizon is not required to provide Service Components because competitors have other reasonable alternatives, then the purpose of the price floor test, as discussed above, is met when the floor is set to cover Verizon's direct incremental cost for the attendant Service Components. However, there is evidence in this case that, theoretically, almost any Service Component could be self-provisioned for a price, even if the cost or other requirements of self-provisioning makes it a poor business decision.[21] Thus, the proposed language must be clarified to apply only in circumstances where other carriers can "reasonably" self-provision or obtain the components from others. That is, the Plan must be modified to provide that Verizon need only reflect the direct incremental cost for such Service Components in the price floor calculation under Section K.2.b "… where other carriers reasonably can either self-provision Service Components or obtain them from other commercial suppliers…." Moreover, other carriers are further protected because: (1) as we clarified above, other carriers may request an investigation to ensure that Verizon complies with the competitive safeguards in Section K; and (2) Section K.2.c requires Verizon, within 30 days of being notified by the Commission in writing of a complaint that a Retail Service does not meet the price floor, to provide data demonstrating that the price

[21] Taylor, Tr. 129-132; Lafferty, Tr. 399-400.

floor is met for that Retail Service. Accordingly, we find that the provisions of Section K, as modified herein, do not unreasonably prejudice or disadvantage other providers of competitive services and protect competitive markets.

Finally, we do not find that the definition of Retail Services in Section K.2 of the Plan must be expanded to include BLETS and OLETS as part of the price floor test. As with the existing regulatory plan, the proposed Plan contains separate provisions regulating BLETS and OLETS – in contrast to competitive and other services to which the price floor test applies. In addition, Verizon explains that BLETS and OLETS do not need to be included in the price floor because "[w]hatever Verizon's tariffed prices for BLETS and OLETS services might be competitors can get those services at a discount off the retail rates. If the tariffed price is below Verizon's costs, competitors get the benefit of that below-cost pricing…."[22] Thus, we find that BLETS and OLETS do not need to be subject to the price floor test in order ensure that the Plan does not unreasonably prejudice or disadvantage other providers of competitive services or to protect competitive markets.

Revenue-Neutral Price Changes

Section G of the Plan permits Verizon to propose revenue-neutral price changes for any BLETS, OLETS, or switched access service. Consumer Counsel requests that the Plan be modified to require Verizon to use any additional revenues generated by the Plan to offset any revenue reductions that may result in the future from reduced switched access charges. We find that such proposal is not necessary to protect the affordability of BLETS and to be in the public interest. Section G of the Plan states that the Commission shall approve revenue-neutral price

[22] Verizon's Post-Hearing Brief at 66.

changes "if it finds that they are in the public interest, or the Commission may refuse to approve the filing if it is not in the public interest or otherwise fails to comply with this Plan." Accordingly, the Plan, as proposed, already prohibits a BLETS price increase resulting from a revenue-neutral filing if the Commission finds that such increase is not in the public interest or fails to comply with the Plan. As a result, it is not necessary that the Plan be modified as requested by Consumer Counsel. For example, if the Company makes a revenue-neutral filing that seeks to increase BLETS and decrease access charges, Consumer Counsel could argue at that time that such price changes are not in the public interest unless additional revenues generated through rate increases under the Plan are used to offset certain revenue reductions. The resolution of this question, however, should be determined based on the evidence provided as part of any particular revenue-neutral filing – not as a generic finding under the Plan.

Next, Section G includes a true-up provision for revenue-neutral prices changes. Specifically, Section G.2 states as follows:

> The Commission may require the Companies to show within the first two years following the implementation of the price changes that the changes are, in fact, revenue neutral. If they are not, the Commission may require a prospective adjustment in the affected prices to ensure revenue neutrality.

Verizon's existing regulatory plan does not include switched access as part of a revenue-neutral price change. Consequently, the true-up mechanism in the existing plan also does not include switched access. In contrast, as noted above, the proposed Plan includes switched access as part of a revenue-neutral price change. Thus, we find that the true-up provision in the proposed Plan – in order to protect affordability and to be the public interest – must also include switched access. This is accomplished by modifying the first sentence of Section L to read as follows: "Pricing for switched access services, except as noted in Section G above, will be considered separately by the Commission."

Finally, we find that Section G does not need to be modified to require a separate public interest determination in order for Verizon to propose a revenue-neutral pricing change that involves both Companies. Section G.1, as proposed, already states that "the Commission may refuse to approve the [revenue-neutral] filing if it is not in the public interest…." No additional public interest test is needed. If the Companies file a combined revenue-neutral pricing change, Section G permits interested persons to assert, and the Commission to find, that such a combined filing is not in the public interest.

CLEC Rules – Incorporated by Reference

Various parts of the Plan incorporate, by reference, rules promulgated by the Commission that apply to CLECs. We find that the substance of each of the referenced CLEC rules does not need to be repeated in the Plan to satisfy the public interest; incorporation by reference is sufficient. However, we find that it is in the public interest to clarify that the CLEC rules referenced in the Plan are incorporated as they exist on the effective date of the Plan – and as they may be amended in the future. Specifically, the following section must be added to the Plan to be in the public interest: "References in this Plan to rules established by the Commission are as such rules exist on the effective date of the Plan, and as such rules may be amended."

Tariff Requirements

Section E of the Plan does not mandate that Verizon file tariffs for Competitive Services. We find that in order to not unreasonably prejudice or disadvantage any class of customers or other providers of competitive services, and to be in the public interest, Verizon should be required to file these tariffs, consistent with the filing requirements placed on all providers. As noted by Verizon, 20 VAC 5-417-50 (A) requires other providers to file these tariffs, unless otherwise allowed by the Commission or unless an ILEC provides a comparable competitive offering that does not require a tariff. Verizon also recognizes that 20 VAC 5-417-50 (C)

permits other providers to petition the Commission to deregulate or detariff any of its specific service offerings. In addition, § 56-235.5 E of the Code states that the Commission shall have the authority to provide for deregulation, detariffing, or modified regulation for competitive services. Accordingly, Section E shall state as follows:

> Tariffs shall continue to be filed for all BLETS, OLETS and Bundled Services. Tariffs shall continue to be filed for any Competitive Services unless otherwise ordered by the Commission. The Commission may approve, upon petition of the Company, the detariffing of a Competitive Service if determined to be in the public interest pursuant to § 56-235.5 E of the Code of Virginia. The prices of Competitive Services and Bundled Services shall not be regulated by the Commission, except as provided for in Sections I (Bundled Services) and K (Competitive Safeguards) of this Plan.

Reporting Requirements

Section J of the Plan states as follows: "Verizon Virginia and Verizon South shall comply with the reporting requirements of 20 VAC 5-417-60 unless otherwise ordered by the Commission, and upon request by Commission Staff, provide publicly available documents." Reporting requirements for CLECs are governed by 20 VAC 5-417-60; we find that it is in the public interest to place these same requirements on Verizon. This also is consistent with the provision of the Local Competition Policy, as set forth in § 56-235.5:1 of the Code, that requires the Commission, as appropriate, to consider it in the public interest to "treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, apply the same rules to all providers of local exchange telephone services." We do not find that the public interest requires, nor is it consistent with the Local Competition Policy, that the reporting requirements be expanded – only for Verizon – to include information on rate of return, capital structure, and rate base. Moreover, as clearly evidenced by the Plan and the statutory criteria that we must apply thereto, Virginia statutes no longer subject Verizon to mandatory cost-of-service regulation by this Commission.

Conversely, we note that § 56-235.5 H of the Code explicitly requires the Commission to monitor the competitiveness of any telephone service previously found by it to be competitive. In this regard, we find that the Plan must be modified to clarify the Commission's ability to obtain information necessary to comply with § 56-235.5 H. Such modification is necessary in order to ensure that the Commission satisfies this statutory obligation in order to not unreasonably prejudice or disadvantage any class of customers or other providers of competitive services, to protect consumers and competitive markets, and to be in the public interest. Specifically, the Plan shall be modified to include the following provision as proposed by the Staff.

> The Companies shall maintain sufficient information to allow the Commission to monitor the competitiveness of any service found to be competitive pursuant to § 56-235.5 F of the Code of Virginia. At minimum, the Company shall provide units and revenues for any Competitive Service within 30 days of a request by either the Commission or the Staff.

Finally, we note that 20 VAC 5-417-60 (F) states that the provider "shall, upon request of the commission staff, file additional information with respect to any of its services or practices." Section J, as proposed by Verizon, in effect modifies this provision – and only for Verizon – by limiting the additional information that may be requested by the Staff to "publicly available" documents. We find that it is not in the public interest, nor consistent with the Local Competition Policy as set forth in § 56-235.5:1 of the Code, to limit such information – only for Verizon – to publicly available documents. Thus, Section J must be modified to provide as follows: "Verizon Virginia and Verizon South shall comply with the reporting requirements of 20 VAC 5-417-60 unless otherwise ordered by the Commission."

Classification of Services

Section D addresses classification of new services and reclassification of existing services. First, we note that there is some question as to whether Section D.4 is broad enough to encompass Verizon's reclassification of existing services. In this regard, for the Plan to be in the public interest, we find that Section D.4 must be clarified to note explicitly that it applies to Verizon's request to reclassify an existing service. Specifically, the first sentence in Section D.4 must be modified to read as follows: "Verizon Virginia, Verizon South, or any interested party may petition for the reclassification of a Verizon Virginia or Verizon South service." In addition, as discussed above regarding other sections of the Plan, such cases will proceed as warranted based on the particular circumstances of each case; thus, we will remove the procedural limitations from Section D.4.

Next, Section D.2 addresses the offering of a new Competitive Service. We find that this provision, as written, is in the public interest. It requires Verizon to file an application and permits the Commission to postpone a new Competitive Service offering for good cause shown. We find that no additional procedural requirements need to be specified in the Plan (such as requiring an opportunity for hearing or the filing of specific evidence) in order for the Plan to be in the public interest. Any proceeding under this section will proceed on its own merits, on a case-by-case basis, in which the Commission will determine if a hearing is necessary and if Verizon has provided sufficient evidence to support its application.

Finally, Section D.5 addresses services that are "deemed competitive" pursuant to Virginia statute. We agree with Verizon that whether these services are "deemed competitive" under the statute is not dependent upon an application to the Commission or upon review by the Staff or the Commission. Thus, we find that it is not necessary for the Plan to require Verizon to submit an application to the Commission regarding these services in order for the Plan to be in

the public interest. In addition, Verizon notes that if any party wishes to challenge the services deemed competitive, such party can petition the Commission accordingly. We find that the ability for such parties reasonably to petition the Commission in this regard is necessary for the Plan to be in the public interest. However, we find that for parties to have a reasonable opportunity to so petition, Verizon's "deemed competitive" services must be filed with the Commission in the form of tariff revisions so that, among other things, such revisions will be on file at the Commission, will be publicly available, and will be clearly identified for interested parties. Thus, we find that Section D.5 must state as follows in order to be in the public interest.

> Verizon Virginia and Verizon South will file tariff revisions with the Commission for services deemed competitive pursuant to § 56-265.4:4 or Article 5.1 (§ 56-484.7:1 et seq.) of Chapter 15 of the Code of Virginia. The Company shall identify the relevant geographic area where the services of the county, city, or town are being offered. If applicable, the Company shall explain in the tariff cover letter the basis for using functionally equivalent services for determining that the services are deemed competitive.

Access Charge Reductions

We do not agree with the assertion of AT&T and MCI that the Commission must reduce access charges to cost-based levels on the same timeline as any approval of the Plan in order to not unreasonably prejudice or disadvantage other providers of competitive services. We find that the current proceeding and pending Case No. PUC-2003-00091, which addresses Verizon's switched access charges and presently is under consideration by the Commission, do not need to be linked as requested by AT&T and MCI. The current case and the switched access case are separate proceedings built upon separate records. Interexchange carriers are not unreasonably prejudiced if the Plan goes into effect before the Commission issues an order in the switched access case.

Public Interest

Pursuant to § 56-235.5 B (iv) of the Code, the Commission may not approve the Plan unless we find that it "is in the public interest." This public interest finding is listed in the conjunctive in subsection B of 56-235.5 of the Code. Thus, "the requisite finding of 'public interest' is an independent finding and not limited by other portions of the subsection." Level 3 Communications of Virginia, Inc. v. State Corporation Commission, et al., 268 Va. 471, 477 (2004) ("Level 3"). Accordingly, we must make a public interest finding separate from our findings under § 56-235.5 B (i)-(iii).

Our finding that the Plan, as modified herein and discussed throughout this Final Order, satisfies the other statutory criteria that we must apply provides some evidence that the Plan is in the public interest. However, pursuant to Level 3, satisfying § 56-235.5 B (i)-(iii) does not mean that the Plan necessarily is in the public interest. In this regard, we must follow the statutory directive set forth in the Local Competition Policy, § 56-235.5:1 of the Code, which explicitly directs the Commission as to certain items that we must consider as in the public interest. Specifically, § 56-235.5:1 states that the Commission shall

> consider it in the public interest to, as appropriate, (i) treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, apply the same rules to all providers of local exchange telephone services; (ii) promote competitive product offerings, investments, and innovations from all providers of local exchange telephone services in all areas of the Commonwealth; and (iii) reduce or eliminate any requirement to price retail and wholesale products and services at levels that do not permit providers of local exchange telephone services to recover their costs of those products and services.

As discussed throughout this Final Order, the Plan as approved herein takes steps, as appropriate, to treat all providers of local exchange telephone services in an equitable fashion and without undue discrimination and, to the greatest extent possible, to apply the same rules to

all providers of local exchange telephone services. In addition, we find that the Plan promotes innovation, efficiencies, and investments by Verizon, provides Verizon with additional flexibility in the competitive market, and, thus, should also stimulate competitive activity by other providers.[23] Furthermore, to the extent that current regulation may require Verizon to price certain BLETS below cost, the Plan moves toward reducing or eliminating such requirement.

Finally, several written comments and public witnesses made allegations of racially discriminatory practices by Verizon, which Verizon denied. While such alleged practices, if true, would not be in the public interest, we make no factual finding herein as to these allegations. Moreover, we must conclude that such allegations have no relation to the proposed Plan. The Plan does not sanction, promote, nor reward discriminatory practices on behalf of Verizon or others. Thus, we must find that the allegations of discrimination provide no basis for the Commission to reject the Plan.

We find that the individual sections of the Plan and the Plan as a whole, as modified by this Final Order, are in the public interest.

Motion to Strike

On December 15, 2004, Cavalier and NTELOS (collectively, "Movants") filed a joint motion to strike certain evidence admitted into the record at the request of Verizon. Specifically, Movants seek to strike the evidence derived by Verizon from the 911 and E911 databases regarding the number of access lines served by competitors in Virginia. Movants contend that Verizon's use of the 911 and E911 databases for such purpose violates Verizon's interconnection agreements with the Movants. Movants also request, in the alternative, that Verizon's application be denied in its entirety as a result of Verizon's breach of contractual obligations and unclean hands. Movants assert that Verizon should not be permitted to prevail in a proceeding in

[23] See, e.g., Exh. 5 at 33-34; Ex. 7 and 7P at 17-18; Ex. 8 and 8P at 17-20.

which it relied upon tainted evidence for the bulk of the evidence supporting the single premise, i.e., increased competition, for its entire application.

We deny the motion to strike, which was filed more than two weeks after the conclusion of the evidentiary hearing. The motion to strike acknowledges that Verizon relied upon evidence in addition to the 911 databases (such as Verizon's wholesale lines, UNE, UNE-P, and resale) in evaluating the number of competitive lines. In addition, the estimated number of competitive lines was not the only evidence of competition provided in this proceeding. Moreover, although Verizon relies on evidence of competition to explain why it filed the instant application requesting a new Plan, Verizon explains in its October 29, 2004, response that it does not rely on evidence of competition to show that it satisfies the requirements of § 56-235.5 B. Verizon's purported premise or rationale for requesting a new Plan is not dispositive as to whether that Plan satisfies the specific statutory criteria necessary for approval. Indeed, our Final Order herein – in determining and explaining whether the Plan satisfies the explicit statutory requirements that we must apply to this application – is not dependent upon Verizon's evidence of competition derived from the 911 and E911 databases.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) The joint motion to strike filed by Cavalier and NTELOS is denied.

(2) The "Verizon Virginia Inc. and Verizon South Inc. Plan for Alternative Regulation" is approved as modified by this Final Order.

(3) The "Verizon Virginia Inc. and Verizon South Inc. Plan for Alternative Regulation," as approved herein and attached to this Final Order, shall become effective as of February 1, 2005, should Verizon elect to adopt it.

(4) On or before January 26, 2005, Verizon shall notify the Commission, by letter filed with the Clerk of the Commission, of its election to adopt the "Verizon Virginia Inc. and Verizon South Inc. Plan for Alternative Regulation" approved herein.

(5) If Verizon elects to adopt the "Verizon Virginia Inc. and Verizon South Inc. Plan for Alternative Regulation" approved herein, on or before January 26, 2005, Verizon shall submit a compliance filing with the Clerk of the Commission, with supporting documentation, identifying for each company-specific BLETS, including company-specific BLETS on an individual rate group basis: (a) the 1994 rate (which shall not include the $0.60 touch tone charge for Verizon Virginia); (b) the 1994 rate in (a) adjusted by GDPPI through 2004; (c) the current rate under the existing regulatory plan; and (d) the price ceiling to be effective as of February 1, 2005.

(6) This matter is dismissed.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, Virginia 23219.

VERIZON VIRGINIA INC. AND VERIZON SOUTH INC.
PLAN FOR ALTERNATIVE REGULATION

A. Applicability of Plan.

1. Upon election, this Plan will apply to Verizon Virginia Inc. ("Verizon Virginia" or "Company") and Verizon South Inc. ("Verizon South" or "Company") and will go into effect on February 1, 2005.

2. Nothing in this Plan shall be deemed to affect the ability or authority of any entity other than Verizon Virginia and Verizon South to offer any telecommunications service.

B. Changes to Plan.

1. Any change to this Plan may occur only after an appropriate proceeding is initiated and held under the provisions of § 56-235.5 D of the Code of Virginia.

2. Any such change approved by the Commission shall have prospective effect only.

C. Classification of Services.

1. Telecommunications services of Verizon Virginia and Verizon South will be classified into four categories called Basic Local Exchange Telephone Services, Other Local Exchange Telephone Services, Competitive Services, and Bundled Services, as defined below. Verizon Virginia's and Verizon South's existing services are distributed among these four categories in accordance with Appendix A and Appendix B hereto, respectively.

2. Service classifications are defined as follows:

a. "Competitive Services" are determined pursuant to § 56-235.5 F of the Code of Virginia.

b. "Basic Local Exchange Telephone Services" ("BLETS") are dial tone line and any included local calling allowance (flat rate, message rate, or measured rate) sold to residence and business customers and that do not meet the definition of Competitive Services. BLETS may also include other services that the Commission determines are essential, non-optional telecommunications services that do not meet the definition of Competitive Services.

c. "Other Local Exchange Telephone Services" ("OLETS") are individual telecommunications services that do not conform to the definition of Competitive Services or the definition of BLETS.

d. "Bundled Services" are packages of services that include services from one or more of the categories defined in C.2.a, C.2.b, and C.2.c above and are offered at an aggregate price.

D. Classification of New Services and Reclassification of Existing Services.

1. Tariffs for new BLETS, OLETS, and Bundled Services shall be filed with notice to the Commission consistent with the requirements for competitive local exchange carriers as provided in 20 VAC 5-417-50 (H) unless otherwise ordered by the Commission. The notice shall include justification for the classification.

2. Upon offering a new Competitive Service, the Company will simultaneously file an application, including justification for the competitive classification, with the Commission in accordance with § 56-235.5 E of the Code of Virginia. The filing of such application shall not result in the postponement of any new Competitive Service offering unless the Commission, for good cause shown, orders otherwise.

3. Any interested party shall be afforded an opportunity, by timely petition to the Commission, to propose that a new service be classified in a different category; however, the filing of such petition shall not result in the postponement of any new service offering unless the Commission, for good cause shown, orders otherwise.

4. Verizon Virginia, Verizon South, or any interested party may petition for the reclassification of a Verizon Virginia or Verizon South service.

5. Verizon Virginia and Verizon South will file tariff revisions with the Commission for services deemed competitive pursuant to § 56-265.4:4 or Article 5.1 (§ 56-484.7:1 et seq.) of Chapter 15 of the Code of Virginia. The Company shall identify the relevant geographic area where the services of the county, city, or town are being offered. If applicable, the Company shall explain in the tariff cover letter the basis for using functionally equivalent services for determining that the services are deemed competitive.

E. Tariff Requirements.

Tariffs shall continue to be filed for all BLETS, OLETS, and Bundled Services. Tariffs shall continue to be filed for any Competitive Services unless otherwise ordered by the Commission. The Commission may approve, upon petition of the Company, the detariffing of a Competitive Service if determined to be in the public interest pursuant to § 56-235.5 E of the Code of Virginia. The prices of Competitive Services and Bundled Services shall not be regulated by the Commission, except as provided for in Sections I (Bundled Services) and K (Competitive Safeguards) of this Plan.

F. Price Changes for BLETS and OLETS.

1. Price changes for BLETS and OLETS shall be governed by 20 VAC 5-417-50 (D), (E), and (G) unless otherwise ordered by the Commission, except the price ceiling shall be as set forth in Section F.2, F.3, and F.4 below.

2. The price ceiling for each Company-specific BLETS shall be the lower of: (a) the 1994 rate for each Company-specific BLETS, including Company-specific BLETS on an individual rate group basis, adjusted annually by the Gross Domestic Product Price Index (GDPPI) through 2004; or (b) the highest tariffed price in effect for BLETS in either Company on the effective date of this Plan. Thereafter, the price ceiling for BLETS will increase annually on the anniversary of the effective date of the Plan by an amount equal in percentage terms to the increase in the GDPPI during the past twelve months.

3. The Gross Domestic Product Price Index used to determine limits on price ceiling increases shall be the final estimate of the Chain-Weighted Gross Domestic Product - Price Index as prepared by the U.S. Department of Commerce and published in the Survey of Current Business, or its successor.

4. During the first twelve months following the effective date of this Plan, price increases for BLETS and OLETS may not exceed 10%. Thereafter, the increase may not exceed a percentage amount calculated by multiplying .0083 times the number of months (equates to 10% per twelve-month period) since the most recent increase. Prices for BLETS and OLETS may only be increased if the service has not experienced an increase in the previous twelve months. In no event may any single increase exceed 25% nor result in the price for a BLETS that exceeds the ceiling in Section F.2 above. Unless otherwise permitted by the Commission, a Company may not charge higher BLETS rates in a lower rate group than in a higher rate group for that Company.

5. Rate Regrouping of Exchanges.

Nothing in this Plan shall be construed to prohibit rate regrouping of exchanges due to growth in access lines or expanded local calling.

6. Extended Local Service (ELS) Calling Adder Rates.

Nothing in this Plan shall be construed to prohibit establishment of ELS Adder rates pursuant to § 56-484.2 of the Code of Virginia, nor to permit increases in any tariffed ELS Adder rates.

G. Revenue-Neutral Price Changes.

1. Nothing in this Plan shall be construed to prohibit the Companies from proposing changes in the price of any BLETS, OLETS, or switched access services that do not result in a net increase in operating revenues for the Companies. The notification provisions of § 56-237.1 of the Code of Virginia will be applied to such proposals; and if

a protest or objection to the revenue-neutral restructuring is filed by the lesser of 150 or 15% of the affected customers, or by an affected carrier, the Commission shall, upon reasonable notice, conduct a public hearing concerning the lawfulness of the restructuring, pursuant to § 56-235.5 of the Code of Virginia. The Commission shall approve such rate changes if it finds that they are in the public interest, or the Commission may refuse to approve the filing if it is not in the public interest or otherwise fails to comply with this Plan. Any price approved under this section that exceeds the then current price ceiling (established under Section F.2) for a BLETS will become the new price ceiling for that service and will thereafter increase in accordance with Section F.2.

2. The Commission may require the Companies to show within the first two years following the implementation of the price changes that the changes are, in fact, revenue neutral. If they are not, the Commission may require a prospective adjustment in the affected prices to ensure revenue neutrality.

H. Individual-Case-Basis Pricing.

Individual-Case-Basis (ICB) or custom-service-package contract pricing is allowed for BLETS and OLETS when a competitive alternative exists for an individual customer but where the service does not otherwise satisfy the requirements of subsection C.2.a of this Plan. The conditions of Section K.2 (Price Floors) must be met. The Company will provide cost documentation to the Staff demonstrating that the conditions of Section K.2 are met for ICBs with service arrangements not previously offered and for ICBs with services whose cost information has changed. Updated cost information will be filed with Staff as available. The Company must also file quarterly with the Staff a proprietary report listing the names of customers with whom new ICB contracts have been executed, the BLETS and OLETS sold under each new contract, and competitive threat information. Upon written request by another party, the Company will disclose to that party the number of customers included in the quarterly report.

I. Pricing for Bundled Services.

Changes to prices for Bundled Services shall be governed by 20 VAC 5-417-50 (D) and (G) unless otherwise ordered by the Commission, except the price ceiling shall not apply. The conditions of Section K.2 (Price Floors) must be met. Upon introducing a new Bundled Service, or changing the price of an existing Bundled Service, the Company will provide cost documentation to the Staff demonstrating that the conditions of Section K.2 are met.

J. Reporting.

Verizon Virginia and Verizon South shall comply with the reporting requirements of 20 VAC 5-417-60 unless otherwise ordered by the Commission.

K. Competitive Safeguards.

1. There will be no increases in the prices for BLETS or OLETS other than as outlined in this Plan.

2. Price Floor:

a. For purposes of Section K.2, "Retail Service" shall be defined as Bundled Services, Competitive Services, IntraLATA Long Distance Message Telecommunications Service, and Individual-Case-Basis arrangements; and "Service Components" shall be defined as Company unbundled network elements, switched access services, BLETS, and OLETS.

b. The price of a Retail Service shall equal or exceed the sum of (i) the lowest-priced combination of any Service Components that can be used to provide the service, plus (ii) any direct incremental costs of other components of the Retail Service, except that where other carriers reasonably can either self-provision Service Components or obtain them from other commercial suppliers, the price floor calculation need only reflect the Company's direct incremental cost for such Service Components. Service Component prices shall be the prices Verizon charges other carriers for those components.

c. Within 30 days of being notified by the Commission in writing of a complaint that a Retail Service does not meet the price floor, the Company will provide under proprietary protection data demonstrating that the price floor is met for that Retail Service.

3. Cross Subsidy.

Pursuant to § 56-235.5 H of the Code of Virginia, revenues from Competitive Services in the aggregate must cover their direct incremental costs, and Verizon Virginia and Verizon South shall file data annually to demonstrate this separately for each Company. Also, the price of an individual Competitive Service must cover its incremental costs.

4. Any party may request a Commission investigation of any rate to ensure that it complies with the competitive safeguards in this section.

L. Switched Access Services.

Pricing for switched access services, except as noted in Section G above, will be considered separately by the Commission. For all other purposes, access services will be included in the categories as shown on Appendices A and B.

M. Service Quality.

Verizon Virginia and Verizon South shall comply with the retail service quality rules at 20 VAC 5-400-80 or other generally applicable retail service quality rules subsequently adopted by the Commission.

N. Monitoring of Competitive Services.

The Companies shall maintain sufficient information to allow the Commission to monitor the competitiveness of any service found to be competitive pursuant to § 56-235.5 F of the Code of Virginia. At minimum, the Company shall provide units and revenues for any Competitive Service within 30 days of a request by either the Commission or the Staff.

O. References to Commission Rules.

References in this Plan to rules established by the Commission are as such rules exist on the effective date of the Plan and as such rules may be amended.